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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-69921; File No. SR-Phlx-2013-72)

July 2, 2013

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Acceptable Complex Execution Parameter

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 1, 2013, NASDAQ OMX PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of the Substance of the Proposed Rule Change

The Exchange proposes to amend the Acceptable Complex Execution Parameter (“ACE Parameter”) in Rule 1080.08(i), which is the price range outside of which a Complex Order (as defined below) will not be executed.

The text of the proposed rule change is set forth below. Proposed new language is italicized; deleted text is in brackets.

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**Rule 1080. Phlx XL and Phlx XL II**

(a) – (o) No change.

••• *Commentary:* -----

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

**.01- .07** No change.

**.08** Complex Orders on Phlx XL.

(a) – (h) No change.

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(i) Acceptable Complex Execution ("ACE") Parameter. The ACE Parameter defines a price range outside of which a Complex Order will not be executed [following a COLA]. The ACE Parameter is either a percentage or number defined by the Exchange on an issue-by-issue basis. [The ACE Parameter percentage shall not be less than 3 percent.] The ACE Parameter price range is based on the cNBBO at the time an order would be executed. A Complex Order to sell will not be executed at a price that is lower than the cNBBO bid by more than the ACE Parameter [percentage]. A Complex Order to buy will not be executed at a price that is higher than the cNBBO offer by more than the ACE Parameter [percentage]. A Complex Order or a portion of a Complex Order that cannot be executed within the ACE Parameter pursuant to this rule will be placed on the CBOOK. The Exchange will issue an Options Trader Alert ("OTA") to membership indicating the issue-by-issue ACE Parameters [percentages]. The Exchange will also maintain a list of ACE Parameters [percentages] on its website.

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## II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

The ACE Parameter feature is designed to help maintain a fair and orderly market by helping to mitigate the potential risk of executions at prices which are extreme and potentially

erroneous. Specifically, the ACE Parameter prevents Complex Orders<sup>3</sup> from automatically executing at potentially erroneous prices by establishing a price range outside of which a Complex Order will not be executed. Currently, the ACE Parameter is a percentage defined by the Exchange on an issue-by-issue basis. The purpose of this proposal is to make the ACE Parameter more flexible and relevant to different types of options by eliminating the 3 percent limit and permitting the ACE Parameter to a number, in addition to a percentage.

Currently, the ACE Parameter is always a percentage, not less than 3 percent. The ACE Parameter is based on the Complex National Best Bid or Offer (“cNBBO”)<sup>4</sup> at the time an order would be executed. A Complex Order to sell will not be executed at a price that is lower than the cNBBO bid by more than the ACE Parameter. A Complex Order to buy will not be executed at a price that is higher than the cNBBO offer by more than the ACE Parameter percentage. A Complex Order or a portion of a Complex Order that cannot be executed within the ACE Parameter will be placed on Exchange’s Complex Limit Order Book (“CBOOK”).<sup>5</sup>

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<sup>3</sup> See Rule 1080.08(a).

<sup>4</sup> See Rule 1080.08(a)(vi).

<sup>5</sup> See Rule 1080.08(f). The Exchange notes that Complex Orders are placed on the CBOOK at their limit price and may trade pursuant to Rule 1080.08(f)(iii), depending on the movement of the cNBBO and application of the ACE Parameter. Although at any given time, the price of a Complex Order may lock or cross another Complex Order on the CBOOK, this is not a prohibited locked or crossed market for purposes of Rule 1086, because such Complex Orders do not constitute a Protected Quotation as defined in Rule 1083. Complex Orders consist of multiple components (rather than one series) and are not disseminated pursuant to the OPRA Plan. If two Complex Orders on the CBOOK cross, they may nevertheless execute against each other, if the execution price is within the ACE Parameter. If, however, the potential execution price is not within the ACE Parameter for one of those orders, those orders would not trade.

For example, assume the ACE parameter is set at 10%, and a PHLX XL participant submits a Complex Order to buy Series A and buy Series B (30 units of the strategy) for a net debit of \$8.40 and a COLA<sup>6</sup> is initiated. At the end of the COLA, the market is:

NBBO for Series A is \$4.50 - \$4.60, size 10 X 10.

NBBO for Series B is \$2.90 - \$3.00, size 10 X 10.

cNBBO for the strategy is \$7.40 - \$7.60.

If the ACE Parameter is set at 10%, executions to buy the strategy (buy Series A and buy Series B) will occur up to \$8.36 ( $\$7.60 + [0.10 \times \$7.60]$ ) but no higher. Any remainder of the order will be placed on the CBOOK at \$8.40.

In its proposal to adopt the ACE Parameter, the Exchange adopted a minimum 3 percent level, similar to the CBOE.<sup>7</sup> At the time, the Exchange believed that this level was reasonable and appropriate, because a marketable order that would deviate from the cNBBO by more than 3% may be indicative of an extreme or potentially erroneous price, and an Exchange participant would likely want to evaluate the affected Complex Order further before receiving an automatic execution. At this time, based on its experience, the Exchange believes that this amount may not be appropriate for all options, such that a lower percentage could be necessary. For example, higher priced options series may benefit from an ACE Parameter of 1%. Consider the following scenario: assume the ACE Parameter is set at 10%, and a PHLX XL participant submits a Complex Order to buy Series A and buy Series B (30 units of the strategy) at the market. Further assume:

NBBO for Series A is \$124.50 - \$124.60, size 10 X 10.

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<sup>6</sup> COLA is the automated Complex Order Live Auction process. See Rule 1080.08(e).

<sup>7</sup> See Securities Exchange Act Release No. 66602 (March 14, 2012), 77 FR 16579 (March 21, 2012) (SR-Phlx-2012-31). See also CBOE Rule 6.53C.08(e).

NBBO for Series B is \$12.90 - \$13.00, size 10 X 10.

cNBBO for the strategy is \$137.40 - \$137.60.

If the ACE Parameter is set at 10%, executions to buy the strategy (buy Series A and buy Series B) will occur up to \$151.36 ( $\$137.60 + [0.10 \times \$137.60]$ ) but no higher. The resulting executions of the Complex Order could vary in price by up to \$13.76 ( $\$151.36 - \$137.60$ ). If the ACE Parameter is set at 1% rather than 10%, executions to buy the strategy will occur only up to \$138.97 ( $\$137.60 + [0.01 \times \$137.60]$ ) but no higher. With the ACE Parameter set at 1%, the variation in execution prices is drastically reduced.

The Exchange also seeks to operate the ACE Parameter not only as a percentage but as an absolute number, representing a certain dollar amount around the cNBBO. The Exchange believes that sometimes an absolute number rather than a percentage would be appropriate, such as when the cNBBO is low priced.

For example, assume the ACE Parameter is set at 10%, and a PHLX XL participant submits a Complex Order to buy Series A and sell Series B (30 units of the strategy) for a net debit of \$0.08.

NBBO for Series A is \$0.25 - \$0.28, size 10 X 10.

NBBO for Series B is \$0.20 - \$0.25, size 10 X 10.

cNBBO for the strategy is \$0.00 - \$0.08.

If the ACE Parameter is set at 10%, executions to buy the strategy (buy Series A and sell Series B) will only be permitted to occur at the offer of \$0.08 since a 10% range of that offer equates to a sub-penny increment ( $\$0.08 + [.10 \times \$0.08] = .088$ ). Allowing an absolute number rather than a percentage for the ACE Parameter in this instance would give the Exchange the ability to offer a range of allowable execution prices rather than only the cNBBO offer.

The Exchange intends to implement these changes to the ACE Parameter in July or August, and will issue an Options Trader Alert (“OTA”) indicating when the changes become operative as well as the issue-by-issue ACE Parameters. The Exchange will also maintain a list of ACE Parameters on its website.

The Exchange also proposes to amend the first sentence of Rule 1080.08(i) by deleting reference to the COLA. The Exchange believes that this was an inadvertent drafting error and now seeks to correct it. Consistent with the fourth sentence, the ACE Parameter applies and is based on the cNBBO at the time an order would be executed, whether or not there was a COLA. The Exchange believes that the fifth and sixth sentences further support this and do not mention a COLA. Regardless, the Exchange believes that it is appropriate to apply the ACE Parameter even when there is no COLA, because the purpose of the ACE Parameter is to protect orders from an execution at a faraway price, which purpose is equally relevant when there is an execution without a COLA. Accordingly, the Exchange believes that applying the ACE Parameter to orders that are not subject to a COLA should be beneficial to users submitting Complex Orders to the Exchange.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>9</sup> in particular, in that it is designed to promote just and equitable principles of trade and protect investors and the public interest, by making slight modifications to the ACE Parameter so that it can better protect investors from extreme and potentially erroneous executions of their Complex Orders. The ACE Parameter, as modified, will continue to promote just and equitable principles of trade by

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<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

preventing executions at prices that are significantly worse than the cNBBO, which the Exchange believes is a fair representation of then-available prices. Like other order protections, such as an Acceptable Trade Range feature,<sup>10</sup> the ACE Parameter is a protection against executions at inappropriate prices and the Exchange believes that it will do so better with the modifications proposed herein.

Respecting the amendment to the first sentence of Rule 1080.08(i), the Exchange believes that applying the ACE Parameter when there is no COLA is consistent with the aforementioned statutory principles, because the ACE Parameter will protect orders from an execution at a faraway price. Specifically, when there is no COLA and therefore no opportunity for price improvement over existing markets, protection from executions at faraway prices is especially useful and likely to promote just and equitable principles of trade and protect investors and the public interest.

The Exchange noted above that Complex Orders are placed on the CBOOK at their limit price and may trade from the CBOOK pursuant to Rule 1080.08(f)(iii). At any given time, the price of a Complex Order may lock or cross another Complex Order on the CBOOK, which is not prohibited, as explained above. The Exchange believes that it is consistent with just and equitable principles of trade and the protection of investors and the public interest for Complex Orders on the CBOOK to, in this way, lock or cross, including because of the application of the ACE Parameter, without interacting, because those orders benefit from the protections of the ACE Parameter in terms of pricing at a reasonable price from the market. Although such orders could have potentially interacted but for the ACE Parameter, the orders are nevertheless protected from unreasonable execution prices, which benefits those who enter such Complex

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<sup>10</sup> See NOM Rules, Chapter VI, Section 10(7) and BX Options Rules, Chapter VI, Section 10(7).

Orders.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Specifically, the proposal does not impose an intra-market burden on competition, because it will be available to all Phlx participants who enter Complex Orders. Nor will the proposal impose a burden on competition among the options exchanges, because, in addition to the vigorous competition for order flow among the options exchanges generally, many options exchanges offer complex order functionality. To the extent that market participants disagree with the particular approach taken by the Exchange herein, market participants can easily and readily direct order flow to competing venues. The ACE Parameter, as amended by this proposed rule change, will not impose a burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>11</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>12</sup>

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<sup>11</sup> 15 U.S.C. 78s(b)(3)(a)(ii).

<sup>12</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change,



At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2013-72 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2013-72. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the

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or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal offices of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2013-72, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Elizabeth M. Murphy  
Secretary

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<sup>13</sup> 17 CFR 200.30-3(a)(12).